

**DRAFT****PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA****Telecommunications Division  
Market Structure Branch****RESOLUTION T-16905  
December 16, 2004****R E S O L U T I O N**

**Resolution T-16905. Citizens Telecommunications Company of California Incorporated (U-1024-C). Request for Approval of Price Cap Mechanism, in Compliance with Decision 89-10-031 and Decision 94-09-065, and Corresponding Adjustments to Surcharges which will be Effective on January 1, 2005.**

**By Advice Letter No. 856 Filed on October 1, 2004.**

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**Summary**

This Resolution authorizes Citizens Telecommunications Company of California, Inc. (Citizens also known as Frontier, A Citizens Communications Company) to increase its annual revenue by \$64,083 effective January 1, 2005. The adopted revenue adjustments and surcharge/surcredit changes are shown in Appendices A and B attached to this resolution.

Citizens requested an annual revenue increase of \$64,083 due to the impacts of ongoing Z-factor adjustments for Interstate High Cost Fund recovery, NECA true-up adjustments, an ongoing payphone deregulation cost reduction and changes to reflect the reallocation in Other Billing and Collection (OB&C) expense.

**Background**

In Decision (D.) 95-11-024, the Commission adopted an incentive-based regulatory framework (called the new regulatory framework or "NRF") for Citizens based on the NRF adopted for SBC (formerly Pacific) and Verizon California Incorporated (formerly GTE California Incorporated or GTEC). The decision requires Citizens to follow the principles of NRF established in D.89-10-031, D.94-06-011, and D.94-09-065.

Following is a brief summary of elements of the Commission's price cap regulation that apply to Citizens:

In D.89-10-031, the Commission adopted an incentive-based regulatory framework for Pacific and GTEC. Prices and rate caps would be indexed annually according to the

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Gross National Product Price Index (GNP-PI) inflation index reduced by a productivity adjustment and also adjusted for a limited category of exogenous events, called Z-factors, whose effects are not reflected in the GNP-PI and are beyond the control of utility management. Only specific types of costs changes were considered Z-factors: changes in federal and state tax laws to the extent they affect the local exchange carriers disproportionately, mandated jurisdictional separations changes and changes to intraLATA toll pooling arrangements or accounting procedures adopted by this Commission.

Z-factor treatment was not authorized for all unforeseen or exogenous events. Normal costs of doing business (including costs of complying with existing regulatory requirements) or general economic conditions were excluded. Included with the price cap indexing mechanism was a mechanism that shared earnings that exceeded a specified level between shareholders and ratepayers.

Since D.89-10-031, the Commission has subsequently issued several decisions that modified the original NRF program. In D.93-09-038, the Commission ordered GTEC to replace the GNP-PI with the Gross Domestic Product Price Index (GDP-PI) as the inflation index commencing with GTEC's 1994-price cap filing. The Commission, in D.94-06-011, also ordered Pacific to replace the GNP-PI with the GDP-PI commencing with Pacific's 1995 price cap filing. In D.94-09-065, the Commission authorized Pacific and GTEC to implement the 1995 price cap rate adjustments through the billing surcharge/surcredit mechanism. Ordering Paragraph 1 of D.95-11-024 requires Citizens to "file revised tariffs consistent with this decision, the revenue requirement and revenues in Appendix C (surcharges/surcredits) and the rates in Appendix E."

Citizens filed for a review of its NRF in March 1999. In D.00-03-040, the Commission approved a settlement agreement between Citizens and the Commission's Office of Ratepayer Advocates (ORA) regarding revisions to Citizens' NRF. Under the settlement, reporting requirements are modified, the Service Quality Assurance Mechanism (SQAM) and depreciation filings are eliminated, three on-going Z-Factors are kept while all others are eliminated, and suspension of the GDP-PI minus productivity factor formula is continued. The sharing mechanism continues to apply to Citizens and earnings between the benchmark and ceiling rates of return are to be shared equally between shareholders and ratepayers.

### **Citizens' Price Cap Filing**

On October 1, 2004, Citizens filed Advice Letter No. 856 requesting billing surcharge/surcredit changes to be effective January 1, 2005 in order to implement the certain ongoing revenue adjustments for 2005.

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Citizens' 2005 price cap filing consists of proposed revenue adjustments for:

- 1. NECA High Cost Fund Recovery** **\$210,398**  
An ongoing Z-factor adjustment that reflects the difference between the final USF expense payments to be received from the National Exchange Carrier Association (NECA) applicable to 1996 and the expected USF payments to be received from NECA applicable to 2004 and half of the expected USF payments to be received from NECA applicable to 2005.
- 2. NECA High Cost Fund True-Up** **\$ 206,599**  
An ongoing Z-Factor adjustment that reflects true-ups to the USF High Cost Program recognized in 2003, due to revised numbers filed by USF recipients which impact the entire fund.
- 3. Payphone Deregulation Adjustment** **\$(186,051)**  
An ongoing Z-Factor adjustment that reflects the impact of payphone deregulation.
- 4. Impact of OB&C Order #80-286** **\$(166,863)**  
An ongoing Z-Factor adjustment that reflects the impact of the transfer of the common line, traffic sensitive and special access charges.

Citizens request a total net revenue increase of \$64,083 to become effective on January 1, 2005. Citizens used an annualized billing base of \$70,190,229 for calculating the surcharge/surcredit effective January 1, 2005. For the purpose of adjusting its price floors, Citizens proposes a GDP-PI Factor of 2.26%, which reflects the adjusted rate of inflation between the second quarters of 2003 and 2004. Citizens based its GDP-PI Implicit Price Deflator on data obtained from the U.S. Department of Commerce, Bureau of Economic Analysis.

As shown above, the net result of ongoing Z-Factor adjustments is an increase of \$64,083 above Citizens' 1996 base year revenues. To collect the revenue from its customers, Citizens requests authorization to modify:

1. The current surcharge to be applied to all Local Exchange Services with the exceptions of Category III Services and the taxes and surcharges currently listed in the tariffs from 0.46% to 0.42%.
2. The current surcredit to all intraLATA toll in the Schedule Cal. P.U.C. No. A9 from (0.50%) to (0.48%).

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3. The current surcredit to all Access Services listed in the Schedule Cal. P.U.C. No. 1-T from (0.50%) to (.048%).

**Notice/Protests**

Citizens stated that a copy of the advice letter and related tariff sheets were mailed to competing and adjacent utilities and/or other utilities and interested parties as requested. Notice of Advice Letter No. 856 was published in the Commission Daily Calendar on October 6, 2004.

No protests were filed.

**Discussion**

**NECA High Cost Fund Recovery**

Citizens Advice Letter No. 856 included a \$210,398 Z-Factor adjustment to reflect recovery from the Interstate Universal Service Fund (USF). USF is a federal program that provides subsidies to qualifying local exchange telephone companies that provide service to customers who live in areas that are expensive to serve. The Federal Communications Commission (FCC) determines which areas qualify as high cost areas.

To qualify for USF subsidies, a telephone company must demonstrate that the actual per-line cost to provide service to telephone customers that are expensive to serve exceeds a national average per-line cost determined by the FCC. Differences between amounts received from the USF by a qualifying company and its actual high costs are collected/refunded from intrastate customers.

Citizen's allocation of the USF adjustment to local exchange services only reflects the Commission's previous treatment of high cost fund adjustments. In 1995, the Commission approved a similar adjustment for GTEC and in 1996, the Commission approved Citizens' request for Z-Factor treatment of reduced recovery from the USF. In both instances, the adjustments were applied to local exchange services only.

In the 2002 price cap resolution T-16715, the Telecommunications Division (TD) recommended that the USF adjustment should comply with D.94-09-065 (OP 61) and to allocate USF costs to the three classes of service: intraLATA access service, intraLATA exchange and private line services, and intraLATA toll services, which are those classes of service used under NRF to allocate surcredits and surcharges. The IRD decision (D.) 94-09-045 specifies the treatment for surcredits and surcharges for local exchange carriers regulated under NRF. The Commission in Resolution T-16715 decided to

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continue the existing practice of allocation of USF cost changes to local exchange services only.

**NECA High Cost Fund 2002 True-Up**

As discussed in Citizens' 2000 price cap, Resolution T-16377, there can be a difference between the actual amount of receipts from NECA and the estimated NECA receipts used to derive the remaining USF amount to be recovered from California ratepayers. An overstatement of USF receipts based upon NECA estimates could result in an over-collection by Citizens, resulting in an over payment by Citizens ratepayers. Just as Citizens is entitled to differences between actual NECA receipts and the USF amount adopted in its 1996 General Rate Case, it is equally responsible for ensuring that any over-collections are appropriately corrected in its price cap filings. The following is an explanation of the NECA procedures for true-ups under the NECA settlement cycle No. 2.1:

**2.1 Data Types**

Each month participants in the NECA pools submit estimates of their revenues and expenses. As actual data becomes known, companies adjust their data to reflect their actual revenues and costs. For this reason, the common line and traffic sensitive pools operate with a 24-month "open window" in which the exchange carrier can revisit prior months to adjust data. Depending on whether they are reporting current estimated or true-up actual data, exchange carriers can make three types of data entry during a current month cycle: data month estimate, data month adjustment, or retroactive adjustment.

As ordered in the 2001 price cap Resolution T-16479 (O.P. 3), starting in the 2002 price cap filing, Citizens is required to submit true-up adjustments, in accordance with NECA true-up provisions. Citizens request NECA High Cost Fund 2005 True-Up adjustments of \$206,599. The Telecommunications Division has reviewed the Citizens filing and believes it is reasonable to recommend adoption of the Citizens proposal of \$206,599 for the NECA High Cost Fund True-Up.

**Payphone Deregulation**

In Advice Letter No. 856, Citizens requests an ongoing Z-Factor adjustment decrease of \$186,051 to reflect the impact of payphone deregulation.

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In its First Report and Order, FCC 96-388, the Matter of Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996, and in the subsequent Order on Reconsideration, FCC 96-439, the FCC ordered the deregulation of all payphone equipment and the removal of interstate and intrastate payphone subsidies. In relevant part, FCC 96-388 specifies that:

We require, pursuant to the mandate of Section 276(b)(1)(B), incumbent LECs to remove from their intrastate rates any charges that recover the costs of payphones.

Payphones were deregulated on April 15, 1997. Citizens correctly began to include payphone deregulation adjustments starting in the 1998 price cap and continuing as an annual adjustment. In A.99-03-027, Citizens requested no change in its basic NRF structure, and requested that the Commission make no changes in the criteria for exogenous factors (Z-Factors) recoverable by Citizens. In D.00-03-040 the Commission allowed Citizens to continue seeking ongoing adjustment decreases for payphone deregulation of \$186,051. Citizens begin with its 1996 base-year revenue requirements and makes annual adjustments for all ongoing and one-time exogenous events. Each year the company starts with a clean slate. In contrast, the other large LECs reflect changes to their price caps on a year-to-year basis. The Telecommunications Division staff has verified that the two approaches produce the same results. The ongoing adjustment decrease of \$186,051 requested by Citizens reflects twelve months of revenue.

The Telecommunications Division recommends adopting the Citizens proposed decrease of \$186,051 for payphone deregulation.

**Impact of Other Billing and Collection (OB&C)**

Citizens requests an ongoing Z-Factor adjustment decrease of \$166,863 to reflect the impact of FCC 80-286 (the OB&C Order). Citizens made annual adjustments to their 1996 base-year revenue requirement for all ongoing and one-time exogenous events. This adjustment is reasonable and the Telecommunications Division recommends adoption Citizens proposed \$166,863 decrease for the OB&C Z-Factor adjustment.

**Price Floors**

The Telecommunications Division has reviewed Citizens' requested price floors, and found them reasonable, and recommends that they be adopted.

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This is an uncontested matter in which the resolution grants the relief requested. Accordingly, pursuant to P.U. Code Section 311 (g) (2), the otherwise applicable 30-day period for public review and comment is being waived.

**Findings**

1. Advice Letter No. 856 filed on October 1, 2004 by Citizens proposes an increase of \$64,083 over its 2004 base-year revenues. The implementation of Citizens 2005 price cap index filing will become effective on January 1, 2005.
2. Citizens Advice Letter No. 856 and its adjustments, supported by workpapers, reflects:
  - a. A GDP-PI factor of 2.26 % to adjust its price floors.
  - b. Z-Factor revenue adjustments to reflect exogenous effects not reflected in the GDP-PI:
    - i. NECA High Cost Fund Recovery of \$210,398.
    - ii. NECA High Cost Fund 2003 True Up of \$206,599.
    - iii. Payphone Deregulation - an ongoing revenue decrease of \$186,051.
    - iv. OB&C Rule Change - an ongoing revenue decrease of \$166,863.
3. Citizens request for an ongoing revenue adjustment associated with the deregulation of payphone is reasonable and should be adopted
4. Citizen's request for an ongoing revenue adjustment associated with OB&C rule changes is reasonable and should be adopted.
5. A total price cap mechanism increase of \$64,083, effective January 1, 2005, is justified and should be adopted.
6. The Telecommunications Division has reviewed Citizens' requested price floor revisions, finds them reasonable, and recommends that they be adopted.

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**THEREFORE, IT IS ORDERED** that:

1. Citizens Telecommunications Company of California Incorporated shall increase its annual revenue by \$64,083 as adopted herein and reflected in Appendix B.
2. Citizens Telecommunications Company of California shall implement billing surcharges/surcredits reflecting the revenue increase ordered in Ordering Paragraph 1, applied to a total billing base of \$73,190,229: a surcredit of (0.48%) on intraLATA access services, a surcharge of 0.42% on intraLATA exchange and private line services and a surcredit of (0.48%) on intraLATA toll services to become effective on January 1, 2005, subject to review and approval by the Telecommunications Division.
3. The revisions to Citizens Telecommunications Company of California Incorporated price floors filed in Advice Letter No. 856 are adopted, and shall be implemented on January 1, 2005.
4. We shall continue the current practice of allocating USF cost changes to intraLATA exchange and private line services.



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This Resolution is effective today.

I hereby certify that the Public Utilities Commission adopted this Resolution at its regular meeting on December 16, 2004. The following Commissioners approved it:

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STEVE LARSON  
Executive Director

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APPENDIX A  
Resolution T-16905

Citizens Telecommunications Company of California Incorporated  
2005 Price Cap Filing  
(in Whole Numbers)

	Citizens Proposed Revenue Impacts	Adopted Impacts
Ongoing Adjustments		
NECA High Cost Fund	\$ 210,398	\$ 210,396
NECA High Cost Fund 2001 True-Up	\$ 206,599	\$ 206,599
Payphone Deregulation	\$(186,051)	\$(186,051)
Impact of OB&C Order #80-286	\$(166,863)	\$(166,863)
Total	\$ 64,083	\$ 64,083

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APPENDIX B  
Resolution T-16905

Citizens Telecommunications of California Incorporated  
2005 Price Cap Filing  
(Adjustments by %)

	Citizens Existing Surcharge/ Surcredit	Citizens Proposed Surcharge/ Surcredit	Adopted Surcharge/ Surcredit
Access	(0.50%)	(0.48%)	(0.48%)
Local	0.46%	0.42%	0.42%
Toll	(0.50%)	(0.48%)	(0.48%)